STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 8131

Petition of Vermont Gas Systems, Inc. for approval of: (1) issuance of First Mortgage Bonds in the amount of $35,000,000; and (2) three-year extension of existing Unsecured Revolving Debt of up to $45,000,000	))))

Order entered: 11/8/2013

I. Introduction

On August 23, 2013, Vermont Gas Systems, Inc. ("VGS" or the "Company"), filed a petition with the Public Service Board ("Board"), pursuant to 30 V.S.A. § 108, seeking the Board's approval to: (1) issue long-term debt in the form of first mortgage bonds in a maximum aggregate offering amount up to $35 million ("the Bonds") by means of private placement; and (2) extend by three years the Company's two existing unsecured revolving credit facilities of up to a total of $45 million (the "Credit Lines") for the purpose of funding future working capital needs and other corporate purposes. The petition was supported by the prefiled testimony of Timothy Keefe, Vice President of Finance and Accounting for the Company, and by accompanying exhibits.

On September 23, 2013, the Vermont Department of Public Service (the "Department") informed the Board that it had reviewed the petition and supporting documentation. Based on its review, the Department recommended that the Board find the Company's petition to be consistent with the general good of the state, without hearing or further investigation.

I have reviewed the petition, the supporting testimony, and accompanying documents, and admit them into evidence. I conclude that approval of VGS's petition pursuant to 30 V.S.A. § 108 is appropriate and that such approval may occur without hearing. Based upon the evidence of record and the testimony and exhibits presented in this docket, and the Department's letter of September 23, 2013, I hereby report the following findings and conclusion to the Board in accordance with 30 V.S.A. § 8.

II. Findings of Fact

1. VGS is a "company" within the meaning of Section 201 of Title 30 of the Vermont Statutes Annotated. VGS transmits and distributes natural gas within the meaning of subsection (2) of Section 203 thereof, and as such it is subject to the Board's jurisdiction. Petition at 1.

First Mortgage Bonds

2. VGS proposes to issue first mortgage bonds in a maximum aggregate offering of up to $35 million by means of private placement. The Bonds will be issued under the Company's First Mortgage Indenture and will be secured by a first lien on all of the Company's utility property. Because the Bonds are to be issued through a private placement, the issuance is exempt from the Securities and Exchange Commission's registration requirements. Petition at 1-2; Keefe pf. at 3.

3. The proceeds of the Bonds will be used to partially fund the Company's long-term capital investments totaling $78 million for fiscal year 2014, including an estimated $60 million investment in the Addison Natural Gas Project (the "ANGP"),[1] and to redeem both existing short-term debt and maturing long-term debt. Specifically, out of the $35 million requested, VGS proposes to devote approximately $25 million to term-out short-term borrowings anticipated to be accumulated prior to, and during, initial construction of the ANGP (including, in part, expenditures incurred for the construction of the distribution line project in Enosburg, Vermont, and the Phase VI Looping Project), and $10 million to refinance long-term debt maturing in February 2014. Keefe pf. at 4.

4. The term and interest rate on the Bonds will be determined by market conditions at the time of placement with investors. VGS anticipates that the term will consist of a 30-year maturity, with the possibility of dividing the issuance between 30-year and 10-year maturities, depending upon what is more favorable in the market. Based on recent 30-year U.S. Treasury Bond yields for fixed rate pricing for a 30-year issuance (approximately 3.87%), along with current offer spreads of approximately 150 basis points for taxable obligations, the Company

---

1. VGS's petition involving the ANGP is currently pending before the Board in Docket No. 7970. Consequently, this Proposal for Decision recommends that the Board grant approval for the ANGP portion of the proposed financing, and the extension of the Credit Lines, only in the event that the ANGP is ultimately approved by the Board. *See* Paragraph 2 of the Order, below.

estimates a fixed coupon rate of approximately 5.37% for a 30-year issuance. Based on 10-year U.S. Treasury Bond yields for a 10-year issuance (approximately 2.83%), with current offer spreads of approximately 120 basis points, VGS estimates a fixed rate coupon of approximately 4.13% for a 10-year issuance. The specific terms of the proposed Bonds, including final interest rates, maturity dates, redemption options, sinking fund obligations (if any), will be determined according to market conditions and negotiated terms with the private placement investors. Keefe pf. at 5-6; exh. TK-1.

5. Absent the issuance of the proposed Bonds, the Company would continue to utilize its short-term debt facilities. However, with the maturity of $10 million of long-term debt in February 2014, combined with the Company's ongoing capital needs, VGS anticipates that the $45 million availability on its Credit Lines would be exhausted by August 2014. Keefe pf. at 4, 11.

6. VGS expects the closing for the Bonds to occur on or around November 23, 2013; however, VGS may decide not to draw on any of the proceeds from the bond issuance until January 2014 depending upon credit market conditions. In the event the ANGP receives Board approval, VGS plans to file with the Board a petition requesting approval of a second round of long-term debt issuance in the latter part of 2014. Keefe pf. at 3, 5.

The Credit Lines

7. VGS currently has two unsecured credit facilities each with a term of 364 days: (1) $30 million with JP Morgan Chase ("JPM"); and (2) $15 million with KeyBank, N.A. ("KeyBank"). VGS proposes to extend the term of both Credit Lines from 364 days to three years so that both facilities would expire on June 30, 2016 (the facilities are currently set to expire in June 2014), thus providing uninterrupted availability of funds as construction of the ANGP ramps up, if approved by the Board. The face amounts of the Credit Lines will remain unchanged. VGS uses the credit facilities to fund working capital and other corporate needs including day-to-day liquidity. Keefe pf. at 7.

8. Interest on the JPM facility will be payable at the Company's option at either the Prime Rate ("Prime Rate"), or at the London Interbank Offered Rate ("LIBOR") plus applicable margin.

With respect to the LIBOR option, VGS may borrow at 30-day LIBOR plus 95 basis points. Interest on the KeyBank facility will also be payable at the Company's option at either the Prime Rate or LIBOR plus the applicable margin. With respect to this facility, VGS may borrow at the Overnight LIBOR rate plus 140 basis points, or at 30-day or 90-day LIBOR plus 125 basis points. Keefe pf. at 7; exh. TK-2.

9. The Company has long-standing relationships with JPM and KeyBank. VGS solicited a bid from a third lending institution; however, the subsequent offer from that institution contained additional fees that made the offer uncompetitive with the proposals from the existing banks. Keefe pf. at 8.

10. The capitalization of the Company as of June 30, 2013, based on a 13-month average,[2] was as follows:

Long-term Debt	$30,000,000
Short-term Debt	$11,968,562
Common Equity	$60,158,466
Capitalization Ratio	58.91%

Assuming approval of the ANGP, the projected capitalization of the Company as of October 31, 2014, based on a 13-month average, and reflecting the impact of the proposed financing, is as follows:

Long-term Debt	$51,153,846
Short-term Debt	$13,130,772
Common Equity	$78,758,147[3]
Estimated Capitalization Ratio	55.06%

2. In projecting the capitalization for both June 30, 2013, and October 31, 2014, VGS used the averages for the prior 13-month periods to better reflect the way VGS manages its equity and debt funding over the course of the given period so as to account for seasonal variations in gas purchases, storage inventory, and advances under the Lines of Credit. This is consistent with the way the Company's rate filings are submitted. Keefe pf. at 9.

3. VGS is a wholly-owned subsidiary of Northern New England Energy Corporation ("NNEEC") which is wholly owned by Gaz Metro Limited Partnership. Exh. TK-3 at 7, 29. The Hearing Officer assumes that this projected increase in equity represents an equity injection from NNEEC to VGS related to the equity portion of the financing for the ANGP.

The projected capitalization ratio for 2014 is in compliance with the 55% ratio contemplated under Section 3(c) of VGS's Successor Alternative Regulation Plan. Keefe pf. at 8-10.

11. VGS does not have a debt rating (secured or unsecured) from any of the major corporate debt rating services; however, it is considered by the National Association of Investors Corporation to have the equivalent of a NAIC-2 rating in the capital markets.[4] Keefe pf. at 10.

III. Conclusion & Recommendation

Based on the record evidence, I conclude that the proposed issuance of long-term debt, and the extension of VGS's two existing credit facilities, as further described in the Company's petition, is in the public good. The proposed financing would provide the Company with the additional capital necessary to finance its working capital requirements and support further expansion of its gas system as approved by the Board. As such, I recommend that the Board find the issuance of the proposed indebtedness to be consistent with the general good of the state and issue an order to that effect.

As noted above, VGS's petition for approval of the ANGP in Docket No. 7970 is still pending before the Board. In the event that the Board does not grant approval of the project, and given that VGS has $10 million of existing long-term debt maturing in February 2014, I recommend that the Board only authorize the portion of the requested bond issuance pertaining to the refinance of the $10 million in first mortgage bonds as outlined in Paragraph 2 of the Order, below. Similarly, since the proposed three-year extension of the Credit Lines is also dependent upon approval of the ANGP, I further recommend that the Board not authorize the extension of the credit facilities absent the Board's approval of the project.

4. In Docket No. 7491, Order of 1/28/09 at 3, VGS represented that its underwriter at the time, Societe Generale Americas Securities, LLC, informed the Company that if it were rated by a credit rating firm, the rating would approximate a BBB rating.

This Proposal for Decision has been served on all parties to this proceeding in accordance with 3 V.S.A. § 811.

Dated at Montpelier, Vermont, this 4th day of November, 2013.

s/Jay E. Dudley
Jay E. Dudley
Hearing Officer

IV. Board Discussion

On October 25, 2013, VGS filed comments on the Hearing Officer's Proposal for Decision. VGS requests that the Board not adopt the Hearing Officer's recommendation to condition approval of the proposed transactions in this Docket on Board approval of the ANGP currently under review in Docket 7970. Accordingly, VGS requests that the Board delete sentences two through four of Condition 2 to the Proposed Order.

In its comments, VGS states that it believes that, based on current market factors, interest rates may continue to rise over the next several months, and that such an increase could be sudden and significant. Therefore, VGS seeks to close on the proposed transactions as quickly as possible to take advantage of current favorable credit market conditions. According to VGS, as proposed, Condition 2 of the Proposed Order would prevent VGS from closing on the proposed transactions on or around November 23 as previously planned. This is because the issuers of the proposed bonds and credit facilities will not close on the transactions until: (1) VGS has obtained a final Board Order; (2) all of that Order's conditions have been satisfied; and (3) the Order's appeal period has expired with no appeal taken. VGS believes this is unlikely to occur until mid-to-late December 2013. VGS also states that bifurcating the issuance of $10 million in bonds from the other $25 million, as contemplated by Condition 2 of the Proposed Order, could adversely affect the marketability of the smaller issuance, thereby exposing VGS customers to higher rates due to higher interest costs. VGS would also incur additional costs associated with executing two private placements rather than one.

VGS maintains that, in the event the Board were not to approve the ANGP, it would still be consistent with the general good of the State for VGS to enter into all of the proposed transactions, for two reasons. First, the balances on VGS's short-term credit lines are currently approximately $25 million, a significant portion of which is attributable to capital work unrelated to the ANGP; it is prudent to secure long-term financing to support these investments at the most attractive rates available. Second, extending the term of VGS's credit facilities would be more efficient than VGS's existing credit arrangement because it would allow VGS to renegotiate its revolving credit agreements less frequently than every twelve months.

Finally, in the event that the Board does not approve the ANGP in Docket 7970, VGS proposes to file a report with the Board "demonstrating why customers were not adversely impacted by the proposed transactions" even though VGS did not go forward with the ANGP.[5]

On October 29, 2013, the Department filed comments on the Hearing Officer's Proposal for Decision. The Department supports VGS's request that approval of the proposed transactions not be conditioned on Board approval of the ANGP. The Department states that it has discussed VGS's concerns with the Company, and believes VGS has provided compelling reasons supporting its request. As a result, the Department continues to maintain that VGS's proposed financing is consistent with the general good of the State, regardless of whatever ultimate decision the Board makes with respect to the ANGP in Docket 7970.

After reviewing the comments on the Proposal for Decision, we conclude that it is appropriate to approve VGS's proposed transactions. We further determine that such approval should not be conditioned on Board approval of the ANGP in Docket 7970.

VGS maintains that it has a need for the full $35 million in new long-term debt whether or not the ANGP is approved by the Board in Docket 7970. As stated by VGS in the prefiled testimony accompanying the petition:

> The borrowing amount for which approval is sought in this Petition ($35 million) is comprised of $10 million to refinance the long-term debt that is maturing in February 2014 and approximately $25 million that would 'term out' short term borrowings that are anticipated to have accumulated prior to the construction of the ANGP, including the construction of distribution line to Enosburg, Vermont, and the Phase VI Looping Project, both of which are currently ongoing.[6]

In addition, with respect to the proposed three-year extension of the credit facilities, VGS maintained in prefiled testimony that:

> . . . should the ANGP not go forward for some reason, [VGS] would not be materially harmed by extending the term of the credit facilities. In those circumstances, it could just choose not to draw on the Proposed Credit Facilities.[7]

---

5. VGS Comments on the Proposal for Decision at 3.

6. Keefe pf. at 4-5.

7. Keefe pf. at 8.

We take this opportunity to remind VGS that it must use the funds borrowed through the proposed transactions in a prudent and used-and-useful manner, regardless of whether the Board approves the ANGP in Docket 7970, or VGS will not be able to recover the borrowed funds from its ratepayers. We understand the Hearing Officer's concern that there could be undesirable consequences if a utility borrowed funds that ultimately proved not to be needed because the Board failed to approve the underlying capital project for which the funds were intended to be used. However, any such consequences of the borrowing would accrue to the utility and its shareholders, not to ratepayers. This is because all utility costs — including expenses incurred in connection with financings — to be recovered from ratepayers must be prudent and economically used-and-useful. If a utility borrows funds, and does not use those funds in a prudent and used-and-useful manner, the utility will not be able to recover the imprudent and non-used-and-useful costs from ratepayers.

We appreciate VGS's offer to file a report with the Board, in the event the ANGP were not approved, demonstrating whether customers were adversely impacted by the proposed transactions even though VGS did not construct the ANGP. However, we determine that such a report is not necessary. Prudence determinations are typically made in the context of a rate change proposal; thus, the prudence of VGS's use of the funds raised through the proposed transactions is appropriately reviewed in the context of a base rate tariff filing.

Finally, we emphasize that our decision today is in no way a determination regarding the ANGP; our decision on whether to approve that proposed project will occur in Docket 7970.

V. ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board ("Board") of the State of Vermont that:

1. The findings and conclusions of the Hearing Officer are adopted, except as modified above.

2. Pursuant to 30 V.S.A. § 108, the Board consents to and approves: (1) the issuance of long-term debt in the form of first mortgage bonds in a maximum aggregate offering amount of up to $35 million by means of private placement; and (2) the extension by three years of two

existing unsecured revolving credit facilities for up to a total of $45 million for the purpose of funding future working capital needs and other corporate purposes, all according to the terms as further described in the petition of Vermont Gas Systems, Inc. ("VGS"), and finds that the same will be consistent with the general good of the State of Vermont.

3. VGS is authorized to mortgage and pledge its real and personal property under VGS's existing First Mortgage Bond Indenture, as set forth in the findings, above.

4. This Order does not constitute approval of VGS's capital structure or of any particular capital or operating expenditure that may be implemented with the proceeds from the issuance of the long-term and short-term debt contemplated in the petition in this docket. Nothing in this approval shall preclude the Vermont Department of Public Service ("Department") or any other party, or the Board, from reviewing or challenging such expenditures of VGS, its resulting capital structure and/or its payment of dividends in any future proceeding.

5. VGS shall inform the Board and the Department of any material change in the terms and conditions of the financing, if any, prior to closing on the first mortgage bonds and prior to execution of the extended credit facilities.

6. VGS shall provide the Board and the Department with a complete set of final executed documents when they are available.

Dated at Montpelier, Vermont, this 8th day of November, 2013.

s/James Volz	)	
	)	PUBLIC SERVICE
	)	
s/John D. Burke	)	BOARD
	)	
	)	OF VERMONT
s/Margaret Cheney	)	

OFFICE OF THE CLERK

FILED: November 8, 2013

ATTEST: s/Susan M. Hudson
Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: psb.clerk@state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and Order.